

Message Text

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SUBJECT: NATIONAL MONETARY COUNCIL FREES INTEREST RATES AND
INCREASES MATURITY ON INSTALLMENT CREDIT

REF: BRASILIA 3419 OF MAY 13, 1974

1. SUMMARY: THE NATIONAL MONETARY COUNCIL, BRAZIL'S
DECISION-MAKING BODY FOR MONETARY POLICY, DECIDED --
ON APRIL 15 -- TO ABANDON INTEREST RATE CEILINGS ON
FIXED TERM DEPOSITS AND LETRAS DE CAMBIO (BILLS OF
ACCEPTANCE) AND TO EXTEND TERMS OF INSTALLMENT CREDIT
FOR THE PURCHASE OF NEW AUTOMOBILES AND DOMESTICALLY-
PRODUCED MACHINERY AND EQUIPMENT TO 36 MONTHS FROM
24 MONTHS. MOVES AND DESIGNED (A) TO ELIMINATE A
SITUATION WHEREBY, BECAUSE OF UNREALISTIC CEILINGS
SET BY THE CENTRAL BANK, FINANCIAL INSTITUTIONS WERE
FORCED TO ENTER INTO "UNDER-THE-TABLE" DEALS TO ATTRACT
FUNDS AND (B) TO STIMULATE AUTO SALES WHICH HAVE BEEN
SAGGING IN RECENT MONTHS. END SUMMARY

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2. THE NATIONAL MONETARY COUNCIL DECIDED ON APRIL 15 TO ABANDON THE POLICY, IN FORCE FOR SOME YEARS, OF HAVING THE CENTRAL BANK SET INTEREST RATE CEILINGS FOR FIXED TERM DEPOSITS AND LETRAS DE CAMBIO (BILLS OF ACCEPTANCE). COUNCIL'S ACTION, HOWEVER, DOES NOT COMPLETELY FREE MARKET FORCES TO DETERMINE THESE RATES BECAUSE THE CENTRAL BANK WILL CONTINUE TO IMPOSE MAXIMUM INTEREST RATES (INCLUDING MONETARY CORRECTION) ON INSTALLMENT CREDITS EXTENDED BY FINANCIAL INSTITUTIONS (WHICH OFFICIALLY GO AS HIGH AS 36 PERCENT PER ANNUM BUT IN FACT ARE MUCH HIGHER). THUS, IN COMPETING FOR FUNDS, FINANCIAL INSTITUTIONS WILL HAVE TO OPERATE WITHIN THE BOUNDARIES DETERMINED BY THESE OFFICIALLLY-DETERMINED LOAN RATES.

3. THE COUNCIL ALSO DECIDED TO REVERSE ITS DECISION OF LAST MAY (REFTEL) BY AGREEING TO PERMIT INSTALLMENT CREDIT FOR PURCHASE OF AUTOMOBILES AND DOMESTIC MACHINERY AND EQUIPMENT TO BE MADE FOR A PERIOD OF UP TO 36 MONTHS INSTEAD OF THE PREVIOUS 24.

COMMENT:

4. THE FINANCIAL COMMUNITY HAD BEEN, FOR SOME TIME, PRESSING THE MONETARY AUTHORITIES EITHER TO ABANDON THE SYSTEM OF SETTING INTEREST RATE CEILINGS ON DEPOSITS AND BILLS OF ACCEPTANCE OR TO MAKING MORE FREQUENT CHANGE IN THEM. SINCE BOTH THESE ASSETS ARE QUOTED AT A NOMINAL INTEREST RATE, WHICH INCLUDES A PRE-FIXED MONETARY CORRECTION, THE ABILITY OF THE FINANCIAL SYSTEM TO ATTRACT FUNDS THROUGH THESE INSTRUMENTS DEPENDED HEAVILY ON INFLATIONARY EXPECTATIONS. IN FACT, DURING THE LAST SEVERAL MONTHS FINANCIAL INSTITUTIONS WERE REPORTEDLY MAKING "UNDER-THE-TABLE" DEALS TO ATTRACT FUNDS. THE MONETARY AUTHORITIES ARE HOPEFUL THAT INTEREST RATES WILL COME DOWN AS A RESULT OF THIS MOVE. THEY APPARENTLY FEEL THAT INFLATIONARY EXPECTATIONS HAVE BEEN DIMINISHING, PARTICULARLY IN LIGHT OF THE LOWER INFLATION RATE DURING THE FIRST QUARTER, AS COMPARED WITH LAST YEAR. WHETHER THEY ARE CORRECT REMAINS TO BE SEEN. HOWEVER, BY CONTINUING TO IMPOSE MAXIMUM RATES ON LOANS, THE AUTHORITIES HAVE PROVIDED A LIMITED OFFICIAL USE

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CHECK AGAINST RATES MOVING UPWARD. COMPETITION FOR FUNDS IS LIKELY TO HURT THE SMALLER INSTITUTIONS. THIS MAY BE INTENTIONAL SINCE, FOR SOME TIME, THE AUTHORITIES HAVE BEEN ENCOURAGING A CONSOLIDATION OF SMALLER, WEAKER INSTITUTIONS, WITH THE LARGER AND STRONGER ONES.

5. WITH RESPECT TO THE INCREASE IN TERMS FOR INSTALLMENT

CREDIT TO 36 MONTHS, THE OBJECTIVE IS VERY
CLEARLY DESIGNED TO STIMULATE THE AUTO INDUSTRY --
THE NERVE CENTER OF BRAZIL'S ECONOMY -- WHICH HAS BEEN
SAGGING IN RECENT MONTHS.
CRIMMINS

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